STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter, on the Commission's own motion, to consider Ameritech Michigan's compliance with the competitive checklist in Section 271 of the Telecommunications Act of 1996.	))))	**Case No. U-11104**

SPRINT'S LEGAL MEMORANDUM CONCERNING SECTION 271 STATUTORY ISSUES

Sprint Communications Company L.P. ("Sprint") respectfully submits this legal memorandum concerning matters of statutory interpretation as the Michigan Public Service Commission ("Commission") considers the compliance by Ameritech Michigan ("Ameritech") with the competitive checklist in Section 271 of the Telecommunications Act of 1996.

This legal memorandum addresses questions developed by the U. S. Department of Justice to assist the National Association of Regulatory Utility Commissioners ("NARUC") and its members in considering Section 271 compliance issues.

QUESTION NO. 1: What constitutes "facilities-based" competition pursuant to Section 271(c)(1)(A)?

The central characteristic of facilities-based competitors is their freedom from reliance on the incumbent LEC's facilities. Thus, in order to meet the requirements of Section 271(c)(1)(A), there must be one or more competitors with sufficient market presence, in the form of their own facilities, to provide both local business and residential subscribers a meaningful alternative to Ameritech.[1] Such carriers must own their own facilities; it is also particularly important that such carriers own

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1 The public policy reasons for insisting on a viable, independent alternative to Ameritech as a prerequisite to Section 271(c)(1)(A) approval specifically and Section 271 approval more generally are discussed in the Affidavit of Ed Phelan submitted on behalf of Sprint in this proceeding ("Phelan Testimony") as well as in the responses to Questions 11 and 12.

significant local loop facilities. The mere leasing of local loop elements from Ameritech would simply continue the current dependence upon Ameritech and is therefore insufficient.[2]

Other factors to be considered, such as the size of the competitors, the scope of their offerings, the percentage of consumers who subscribe to those offerings, and the percentage of consumers to whom the services are available are all important considerations in the Section 271(c) analysis. But Congress did not intend that the test should turn on any specific quantitative measure of the competitive LECs' market presence. Rather, regulators should examine more generally whether the presence of competitive carriers in the local market (1) demonstrates that, in fact, the barriers to local entry have been effectively lowered and genuine facilities-based competition has emerged, and (2) effectively restrains the incumbent's ability to use its local monopoly to harm competition in the long distance market.[3]

Neither of these requirements has been met in Michigan. Indeed, not one competitive carrier is currently providing local exchange service predominantly over network facilities that it owns. Since there is only de minimis facilities-based competition in Michigan, Ameritech cannot meet the requirements of Section 271.

QUESTION NO. 2: Can Ameritech meet the requirements of Section 271(c)(1)(A) by entering into one or more interconnection agreements, or should the market first be effectively competitive before the Company can be deemed to have met the requirements of Section 271(c)(1)(A)?

Certainly the mere act of entering into an interconnection agreement does not satisfy the statute. The requirements of Section 271(c)(1)(A) ("Track A") are met only when at least one carrier has reached a binding interconnection agreement with Ameritech under which access and interconnection services are being provided in a fully functional manner and the interconnecting

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[2] These issues are discussed in the responses to questions 5 and 6.

[3] These issues are discussed in the responses to questions 11 and 12.

carrier is providing local exchange service to residential and business customers in Michigan either exclusively over its own independent facilities or predominantly over its own independent facilities.[4] Prescinding from any precise characterization of the market as "effectively competitive," the significant point is the requirement that Ameritech prove that facilities-based competitors are in fact operational in the local market and that it has fulfilled each of its obligations to enable additional entry and expansion.

This reading is supported by the terms of the statute and its legislative history. Section 271(c)(1)(A) requires that Ameritech enter into one or more interconnection agreements specifying the terms and conditions under which Ameritech "is providing access and interconnection to its network facilities" (emphasis added). The use of the present tense indicates that Congress intended that a BOC be in the business of providing access and interconnection to operational competitors in order for subsection (c)(1)(A) to be met. Thus, the incumbent must have received and satisfied service requests from the new entrants, and actually be exchanging traffic with them.

The statute is clear that merely offering such services is insufficient under Track A. Throughout Section 271, Congress specifically and carefully distinguished between the active provision of access and interconnection required under Track A and the offering of access and interconnection required under Section 271(c)(1)(B) ("Track B"). For example, each of subsections 271(c)(1)(A), (c)(2)(A)(i)(I), and (d)(3)(A)(i) require that the BOC is providing access and interconnection in order to meet Track A. In contrast, in subsections 271(c)(1)(B), (c)(2)(A)(i)(II) and (d)(3)(A)(ii), all provisions describing the obligations of the BOC pursuant to Track B, the statute states only that the BOC must offer or be offering access and interconnection.

The legislative history of the phrase "is providing" further supports this interpretation. The Conference Report states that "the requirement that the BOC 'is providing access and

[4] The meaning of "predominantly over their own telephone exchange service facilities" is discussed in the response to question 6.

interconnection' means that the competitor has implemented the agreement and the competitor is operational."[5] That explanation could not be clearer.

Section 271(c)(1)(A) requires more than the presence of one or more "operational" competitors. To meet the Section 271(c)(1)(A) standard, the competitors must provide "telephone exchange service . . . to residential and business subscribers . . . either exclusively over their own telephone exchange service facilities or predominantly over their own telephone exchange service facilities."[6] In order to be meaningful, the requirement should be read to require that the competitors constitute a genuine, facilities-based alternative to the incumbent for both residential and business users. Without this requirement, regulators cannot be sure that the barriers to entry into those markets have been effectively lowered and that end users and long distance carriers have a true alternative to the BOC for exchange and exchange access services.[7]

This level of market entry may not, indeed probably will not, be achieved at first.[8] It is likely that competitive carriers reaching interconnection agreements will initially provide service, especially in the case of small and medium volume users, substantially through network elements leased from the incumbent or through resale of the incumbent's services. But those new entrants will also have to invest in their own network facilities if they plan to compete over the long run. When that investment reaches the point at which the new entrant is predominantly facilities-based and constitutes a meaningful alternative to the incumbent LEC, then and only then, will Section 271(c)(1)(A) be satisfied.

Congress recognized that Section 271(c)(1)(A) is unlikely to be satisfied immediately upon State Commission approval of an interconnection agreement. The Conference Report statement

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5 S. Rep. No. 230, 104th Cong. 2d Sess. 148 ("Conference Report").

6 The requirement that the competitor provide service exclusively or predominantly over its own independent network facilities is discussed in the response to question 5.

7 These issues are fully discussed in the responses to questions 5 and 6.

8 This is certainly true if Ameritech continues to insist upon filing its application prematurely, as it threatens to do.

quoted above, that a carrier must be "operational" before the BOC can be understood to be providing access and interconnection, supports this view. Moreover, Section 271(c)(1)(B)(ii) also demonstrates the point. That provision essentially states that a BOC need not meet the requirements of Section 271(c)(1)(A) if the only facilities-based carrier to whom it is providing interconnection and access services "violates the terms of an agreement approved under Section 252" by failing to comply with "the implementation schedule contained in such agreement." The implication is that Section 271(c)(1)(A) is not satisfied until, at the very least, the implementation schedule in an interconnection agreement has been completed. This general recognition that compliance with Section 271(c)(1)(A) might take time is logical in light of the requirement that one or more competitors provide service predominantly over their own networks.

QUESTION NO. 3: Should a competitor be of a specified size and its offerings of a specified scope in order to be deemed a viable competitive alternative under Section 271(c)(1)(A)?

As mentioned in response to Question 1, and discussed more fully in Ed Phelan's Affidavit, the central issue for the Commission under Section 271 is to ensure that the local market has been opened. The best way to make that determination, as Congress recognized, is to be able to observe competitors with independent network facilities that provide meaningful alternatives to the incumbent LEC for the provision of access and local services.

The size of the competitors and the scope of their offerings must be considered in determining whether that test has been met. But these issues must be considered in the broader context of the market analysis. Given Congress' rejection of a market share or "metrics" test, it would be imprudent to set an inflexible, specific standard for compliance.

QUESTION NO. 4: Should the competitor's service be available to a specified percentage of the consumers in the market before the Company can be deemed to have met the requirements of Section 271(c)(1)(A)? Should the competitor be actually providing service to a specified percentage of that universe of consumers before the Company can be deemed to have met the requirements of Section 271(c)(1)(A)?

Again the real issue under Section 271(c)(1)(A) is whether there are significant independent competitors in the local market. While the percentage of consumers in a market that has subscribed to one or more competitors or to whom the alternative services are available may be helpful as a rough guide to determining the competitiveness of the local market, Congress decided that the analysis should ultimately be qualitative, not quantitative.

QUESTION NO. 5: Should the facilities-based competitor own its own facilities, or would the facilities-based competition requirements of 271(c)(1)(A) be satisfied if the competitor leased unbundled elements from Ameritech?

Section 271(c)(1)(A) is satisfied only where one or more competitive LECs offer service to both residential and business subscribers either exclusively or predominantly over facilities that they own. This is clearly the most natural and logical reading of the phrase "over their own telephone exchange service facilities."

There is no basis for contending that this phrase refers to unbundled network elements as well as the competitor's own independent network. Under this strained interpretation, a carrier that provides service exclusively over leased elements or predominantly over leased elements in combination with resold services would meet the Section 271(c)(1)(A) standard. In other words, a carrier with no independent network facilities whatsoever should qualify as a "facilities-based" carrier. This makes no sense.

First, there is no support in the language of the provision for this view. Section 271(c)(1)(A) does not even mention leasing of unbundled elements. As demonstrated by Sections 251(c)(3) and 252(d)(1), Congress was fully capable of referring explicitly to leasehold arrangements when it chose to do so.

Moreover, the legislative history is replete with indications that Congress intended that only carriers with their own independent facilities would satisfy the requirements of Section 271(c)(1)(A). For example, the Conference Committee Report states as follows:

> This conference agreement recognizes that it is unlikely that competitors will have a fully redundant network in place when they initially offer local service, because the investment necessary is so significant. Some facilities and capabilities (e.g., central office switching) will likely need to be obtained from the incumbent local exchange carrier as network elements pursuant to new section 251. Nonetheless, the conference agreement includes the "predominantly over their own telephone exchange service facilities" requirement to ensure a competitor offering service exclusively through the resale of the BOC's telephone exchange service does not qualify, and that an unaffiliated competing provider is present in the market.[9]

As this statement demonstrates, Congress allowed a carrier providing services "predominantly" over its own independent facilities to qualify under Section 271(c)(1)(A) solely because it thought it unlikely that there would be any facilities-based competitors with "exclusively" their own facilities in the market. The import is that a carrier qualifying as facilities-based would under any circumstances have substantial independent facilities. If this were not Congress' intent, there would have been no need even to discuss the likely existence of "redundant" networks that may need to lease "some" of the incumbent's network in describing the purpose of Section 271(c)(1)(A).

Moreover, Congress' concern with the prospects of local competition in its explanation of the meaning of Section 271(c)(1)(A) again shows its intent that facilities-based carriers would own distinct physical facilities. The Conference Report discusses at length the "meaningful facilities-based competition" made possible solely by the fact that "cable services are available to more than 96 percent of United States homes."[10] As the Conference Report concludes, "[s]ome of the forays of the cable companies into the field of local telephony therefore hold the promise of providing the sort of local residential competition that <u>has consistently been contemplated</u>."[11]

There are further indications of Congress' expectation that facilities-based carriers would provide service over independent upgraded cable plant. The House Commerce Committee reasoned that, because the cable industry "has wired 95% of the local residences in the United States[, it] thus

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9 Conference Report at 148.

10 <u>Id.</u>

11 <u>Id.</u> (emphasis added).

has a network which could lead to meaningful competition." Further, Representative Hastert (R-IL), a senior Member of the House Commerce Committee, described a facilities-based competitor as "a competitor with its own equipment in place."[12] Another senior member of the House Commerce Committee described elements "owned by the competing provider."[13]

Congress was well aware that pure resale offers local subscribers, local competitors and long distance carriers virtually no protection against the abuses of BOC monopoly power.[14] Leasing of unbundled elements offers little more protection than pure resale of the BOC's end user services. A lessor under Section 251 does not in any meaningful sense "control" the element it leases; that control remains within the exclusive control of the incumbent LEC. Ameritech does not take issue with this, unsurprisingly. Under either arrangement, the bottleneck facilities remain, and the BOC retains full control over them. This cannot be what Congress intended.

QUESTION NO. 6: How should the phrase "predominantly over their own telephone exchange facilities," as that phrase is used in Section 271(c)(1)(A), be defined?

Sprint believes that to give full import to the term "predominantly" as used in Section 271(c)(1)(A), the Commission must consider the term both qualitatively and quantitatively. As a quantitative matter, the word should be given its common meaning, that is, "having ascendancy,

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12 142 Cong. Rec. H1152 (daily ed. Feb. 1, 1996) (emphasis added).

13 141 Cong. Rec. E1699 (daily ed. Aug. 11, 1995) (comments of Rep. Tauzin (R-LA) regarding the meaning of "predominantly over their own telephone exchange service facilities") (emphasis added).

14 For example, the explanation given by the United States Department of Justice of the limits of resale in the context of Ameritech's 1995 request to receive limited in-region interLATA relief was part of the legislative record:

> Resale competition is not a replacement for facilities-based competition . . . It brings competition only to the marketing of local exchange services, and it requires extensive regulations to ensure that the prices, terms and conditions under which Ameritech offers the underlying service make resale meaningfully available.

Inserted into the record by Senator Byrd. 141 Cong. Rec. S5969 (daily ed. May 2, 1995).

influence, or authority over others; superior; dominating; controlling."[15] At a minimum, this means substantially more than 50%, as measured, e.g., by investment.[16]

More significantly, however, the term must be understood to describe a requirement that encompasses the relative competitive significance of the interconnector's network facilities. Independent back-office operations, for example, are important, but they do not by any means represent the undoing of the bottleneck which Ameritech and other Bell Operating Companies enjoy. As explained in Sprint's response to Question No. 5, the phrase "over their own telephone exchange facilities" refers to independent facilities owned by the competitor. The qualifying terms, "exclusively" or "predominantly," must be understood to explicate and emphasize the importance of those facilities, and must therefore include local loop facilities. Thus, the phrase in question should be defined to mean that the competitive carrier provides service to most of its customers in the state over its own facilities independent of any facilities that it may also lease from the incumbent carrier to provide service to fewer customers via resale or unbundled local network elements.

The legislative history of Section 271 supports this conclusion. When the "predominantly" language was added on the floor of the House,[17] a senior Member of the Commerce Committee stated that the provision required a competitor to own "more than 50% of the local loop and switching facilities" it used to provide service.[18] The same Member stated that, to determine the proportion of the network owned by the CLEC, regulators should "consider only the local loop and

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15 Webster's New Twentieth Century Dictionary Unabridged (1979).

16 The FCC has consistently interpreted the term "predominantly" to mean more than 50%. See e.g., Complaint of WNYC Communications Group Against Time Warner City Cable Group Request for Carriage, 8 FCC Rcd. 3925 at ¶ 4 (1993); Implementation of the Cable Television Consumer Protection and Competition Act of 1992, 8 FCC Rcd. 2965 at ¶¶ 4, 5 (1993). There is no reason to think that these precedents should not be followed in the case of Section 271.

17 House Commerce Committee Chairman Bliley (R-VA) introduced a manager's "en-bloc" amendment which added the "predominantly" language to the bill. See 141 Cong. Rec. H8445 (daily ed. Aug. 4, 1995) (text of the amendment). The Conference adopted "virtually verbatim" the House provision which became Section 271(c)(1)(A). See Conference Report at 148.

18 141 Cong. Rec. E1699 (daily ed. Aug. 11, 1995) (comments of Rep. Tauzin (R-LA)).

switching facilities."[19] Congress' repeated references to cable companies as the most likely facilities-based competitors similarly reflects an emphasis on local loop infrastructure in determining whether facilities-based competition exists.[20]

Furthermore, the Conference Report (and Section 271(c)(1)(A) itself) specifically states that carriers providing solely "exchange access" would not meet the requirements of Section 271(c)(1)(A).[21] This statement again shows that Congress expected that facilities-based providers would own their own loops, since competitive access providers must rely on the incumbent LECs' loops to carry switched traffic.

This is the only interpretation of "predominantly" that is consistent with the goal of the Telecommunications Act. Competitors who must rely upon the incumbent to lease facilities to provide service to customers cannot and do not offer a real competitive alternative. Indeed, so long as competitors must or do lease facilities from the incumbent, the incumbent remains the underlying monopoly with all of the opportunity and incentive to harm, if not prevent, competition. The goal is to have local competitors construct and operate genuine facilities alternatives to the incumbent, so that the incumbent's monopoly power will be dissipated, and consumers will be able to enjoy the benefits of real choices in service quality, technology and value.

QUESTION NO. 7: Should the term "predominantly," as that term is used in Section 271(c)(1)(A) mean that less than some fixed percentage -- e.g., 25% or 50% -- of the services provided by the competitor rely on resale of Ameritech's services?

As explained in response to Question No. 6, the term predominantly should mean that the competitive LEC provides its services mainly (at least more than half) over network facilities, including local loops, owned and controlled by it.

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19 Id.

20 See response to question 5.

21 See Conference Report at 147-148.

QUESTION NO. 8: Should the term "predominantly," as that term is used in Section 271(c)(1)(A), be read to require predominant usage of the competitor's own loop facilities?

Yes. As Sprint has explained in response to Questions 5 and 6, Section 271(c)(1)(A) requires that a facilities-based carrier must own its own loop facilities, and further that it must use "predominantly" those facilities in providing its local exchange services. Thus, the extent of the competitive carrier's loop facilities will be an important consideration in an assessment of whether the carrier meets the Section 271(c)(1)(A) standard. The competitive carrier's loop facilities should be extensive enough to establish it as a truly independent alternative provider of local telephone service and exchange access service.

QUESTION NO. 9: In order for the requirements of Section 271(c)(2)(B) to be met, must all items in Section 271(c)(2)(B) be addressed in a single agreement or may they be made available through multiple agreements and/or tariffs or statements of generally available terms?

Sprint respectfully submits that the Commission keep in the forefront of its consideration the sound policy objectives of the requirement for checklist compliance: that interconnection and access be available, on a non-discriminatory basis, to a variety of competing firms which will, in all likelihood, access and interconnect with the ILEC's network in a variety of ways. One size does not fit all.

Whether Track A compliance with Section 271(c)(2)(B) may be achieved in a single agreement or multiple interconnection agreements, is therefore inextricably tied to the practical realities of the interconnection arrangements actually available. One agreement that purports to meet each item of the checklist may not be sufficient if it in fact fails to provide, on reasonable and nondiscriminatory terms, certain items that had been irrelevant to one type of competitor but crucial to another. By the same reasoning, multiple agreements must not be allowed to become the anticompetitive tool of the ILEC, who could use multiple agreements to segment its competitors and mask discriminatory treatment contrary to the statutory requirements.

One key determinant here will be the rigor with which the Commission enforces the "most favored nation" obligation of Ameritech as set forth in Section 252(i). Section 252(i) requires LECs to make available "any interconnection, service or network element" provided under an interconnection agreement to which it is a party "to any other requesting telecommunications carrier upon the same terms and conditions as those provided in the agreement." The most favored nation provision thus establishes the central mechanism for enforcing the requirement that access and interconnection services on the checklist be truly available and provided in a nondiscriminatory manner.[22]

The roles of the Track A Section 271(c)(2)(B) requirements and the MFN Section 252(i) obligation are thus complementary. Compliance with Section 271(c)(2)(B) pursuant to Track A requires that the incumbent is actually providing all of the checklist items pursuant to "one or more" interconnection agreements. Compliance with Section 252(i) requires that each term of those agreements be available to any requesting carrier on the same basis. The combination yields confidence that additional competitors are also able to enter and expand by utilizing the existing agreements.

As the FCC recognized in its First Report and Order implementing Sections 251 and 252 of the Communications Act, this scheme will work only if third parties can obtain access to any individual interconnection, service or network element arrangements contained in an approved interconnection agreement.[23] Indeed, the more disaggregated the approach to MFN, the more effectively it will work to prevent discrimination and lower the barriers to local entry. This is because each new entrant will likely require a different combination of checklist services for entry. Moreover,

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[22] See 47 U.S.C. § 271(c)(2)(B)(ii), (iii), (vii), (ix), (x), (xii). In addition, incumbents are required to provide interconnection, access to unbundled elements and the other services mandated by Section 251(c) on a nondiscriminatory basis. See generally 47 U.S.C. § 252(c).

[23] See Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order, CC Docket Nos. 96-98, 95-185 at ¶ 1310 (released August 8, 1996) ("FCC Interconnection Order").

bundled offerings by the incumbent LEC may be in reality discrimination schemes in contravention of the statute. Thus, MFN should be implemented to allow competitors to pick and choose specific aspects of existing interconnection agreements to essentially create their own agreements.

Moreover, as the FCC acknowledged in its Section 251-252 First Report and Order, permitting carriers access only to entire agreements or only to large pieces of the agreement creates perverse incentives for the incumbent. For example, under such an arrangement, Ameritech would have the incentive to try to make each agreement unattractive to third parties by including onerous terms and conditions for a service that the other contracting party does not need. In essence, this practice would enable the incumbent to discriminate among competitive carriers in violation of the statute by ensuring that only an actual party to an agreement receives the benefits of that agreement.

Of course, the Eighth Circuit's stay pending appeal of the FCC's MFN rules has left the status of that provision uncertain just at the time when new entrants are planning their entry strategies and negotiating interconnection agreements.[24] That process will therefore be much more successful in Michigan if the Commission independently adopts the FCC's MFN rules for the purposes of interconnection agreements within the state. Sprint respectfully urges the Commission to do so.

As to Ameritech's assertion that it may satisfy Section 271(c)(2)(B) by combining interconnection agreements with a statement of generally available terms to satisfy Section 271(c)(2)(B), this is impermissible. Section 271(c)(2)(B) contains two entirely independent means of compliance.

The provision states as follows:

> Access or interconnection provided or generally offered by a Bell operating company to other telecommunications carriers meets the requirements of this subparagraph if such access and interconnection includes each of the following . . .[25]

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[24] See Iowa Utils. Bd. v FCC, No. 96-3321 (8th Cir. Oct. 15, 1996).

[25] 47 U.S.C. § 271(c)(2)(B).

As used in this subparagraph, the term "provided" matches the phrase "is providing" in Sections 271(c)(1)(A) and (c)(2)(A)(i)(I) as well as the term "provided" used in Section 271(d)(3)(A)(i). All of these provisions refer to compliance with Track A. As used in Section 271(c)(2)(B), the phrase "generally offered" matches the use of "generally offers" in Section 271(c)(1)(B), "is generally offering" in Section 271(c)(2)(A)(i)(II) and "generally offered" in Section 271(d)(3)(A)(ii). All of these provisions refer to compliance with Track B. Thus, as stated in Section 271(c)(2)(B), access and interconnection "provided" refers to Track A while the access and interconnection "generally offered" refers to Track B.

The use of the disjunctive "or" in Section 271(c)(2)(B) demonstrates that a carrier must either comply with the competitive checklist contained in that subparagraph exclusively through Track A or exclusively through Track B. As the Supreme Court has held, "canons of construction ordinarily suggest that terms connected by a disjunctive be given separate meaning, unless the context dictates otherwise."[26]

Far from dictating some other interpretation of the term "or" in Section 271(c)(2)(B), the "context" of Section 271 only reinforces the view that Tracks A and B cannot be used in combination. Every place the two Tracks are mentioned in Section 271, they are stated in the disjunctive. For example, Section 271(c)(1) states that a BOC meets the requirements of that paragraph "if it meets the requirements of subparagraph (A) [Track A] <u>or</u> subparagraph (B) [Track B]" (emphasis added). Section 271(c)(2)(A) similarly states that a BOC meets the requirements of that paragraph if, within the state for which the authorization is sought, the company complies with Section 271(c)(1)(A) or Section 271(c)(1)(B). Section 271(c)(2)(B) restates these options in the disjunctive again.

Finally, Section 271(d)(3)(A) requires that Ameritech has either "fully implemented" the competitive checklist pursuant to Track A or "offers <u>all</u> of the items included in the competitive checklist in subsection (c)(2)(B)" (emphasis added) pursuant to a Track B statement of generally

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26 <u>Reiter v. Sonotone Corp.</u>, 442 U.S. 330, 339 (1979).

available terms and conditions. Section 271(d)(3)(A) again unmistakably shows that the competitive checklist must be fulfilled either entirely pursuant to one or more Track A interconnection agreement or entirely pursuant to a Track B general statement.

Question No. 10. Describe the factors that should be evaluated in assessing whether in-region interLATA authorization for Ameritech would be consistent with the public interest, convenience and necessity. Are current conditions such that authorization for Ameritech to provide in-region interLATA service would be consistent with the public, interest, convenience and necessity? If not, why not? If not, what changes are needed before such authorization would be consistent with the public interest, convenience and necessity?

Congress determined that no BOC should be allowed entry into the interLATA market within its region until it has relinquished its monopoly stranglehold over the local exchange markets on a state-by-state basis. Since this has not been done in Michigan, it would violate the public interest to permit Ameritech in-region, interLATA relief in Michigan.

The public interest reasons for this requirement are multifold. First, interLATA entry is the only incentive which can be given to a BOC to cooperate in opening its local monopoly. Absent holding out the "carrot" of interLATA entry, no BOC would rationally relinquish its bottleneck and voluntarily aid in bringing about competition.[27] The readily observable conduct of GTE in the wake of efforts by this Commission and the Federal Communications Commission to establish competitively neutral rules for interconnection, demonstrates this point succinctly.[28] As the CEO of

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[27] See Phelan Affidavit at 3-4. As the FCC has found:

> incumbent LECs have no economic incentive, independent of the incentives set forth in sections 271 and 274 of the 1996 Act, to provide potential competitors with opportunities to interconnect with and make use of the incumbent LEC's network and services.

FCC Interconnection Order at ¶ 55.

[28] See, "Holding the Line on Phone Rivalry, GTE Keeps Potential Competitors, Regulators' Price Guidelines at Bay" Washington Post, October 23, 1996, at C12.

Ameritech Corp., so aptly stated: "The big difference between us and them [GTE] is they're already in long distance. What's their incentive to cooperate?"[29]

Ameritech must persuasively demonstrate to the Commission that the competitive checklist of Section 271 has, in fact, been "fully implemented."[30] It is not sufficient to submit, as Ameritech has done, expectations, anticipations, or hopes. For example, the difficulties of implementing electronic bonding will not be fully known until the parties actually attempt it; electronic bonding will not in fact be "fully implemented" as required by the statute until it is demonstrably used and useful to the parties. Had Congress thought it sufficient that a BOC merely promise or even legally commit to certain action as a precondition to entry, it could have and would have written this into law. Instead, what Congress has mandated is that the checklist be "fully implemented." This Ameritech has plainly not done. And, as Congress wisely foresaw, once Ameritech is allowed to "eat the carrot," it will have little if any incentive to fulfill its commitments.

There are, of course, other public interest considerations that weigh heavily against grant of interLATA authorization at this time. Without adequate competition established at the local exchange level, there will be no market disciplining effect on Ameritech to refrain from anticompetitive conduct in the interLATA market. As described by FCC Chief Economist Joseph Farrell:

> The BOCs' incentives and ability to discriminate against rivals in long-distance -- to take the most prominent example of MFJ prohibitions -- depend on their market power in the local bottleneck. If we can open up the bottleneck and implement vigorous competition there, then BOCs will have little or no incentive to raise the costs of their long-distance partners -- and if they do so, those long-distance carriers and their customers will have other choices, so the harm to consumers will be limited. Thus, when there is enough competition in what is now the local bottleneck, it will make good sense to let the BOCs into complementary businesses such as manufacturing and long distance.[31]

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29 Id. at C14.

30 See 47 U.S.C. § 271(d)(3)(A)(i).

31 Farrell, Joseph, "Creating Local Competition," (speech as prepared for delivery) May 15, 1996, Washington, D.C. at 6.

Discrimination and cross-subsidization remain serious threats to the interLATA competitive market. While this Commission will undoubtedly be diligent in monitoring for this type of misconduct, the anticompetitive opportunities available to Ameritech will be virtually countless. It need only adversely adjust any one of large numbers of access "details" and thereby seriously disrupt the interLATA market.

Ameritech could also mask its behavior in ways that will be difficult to remedy.[32] This Commission need only look at Ameritech's cynical effort earlier this year to supposedly "protect" consumers from slamming -- a ruse intended to impede competitive inroads into its intraLATA toll monopoly. This Commission wisely enjoined Ameritech from this practice, but Ameritech can replicate this experience in myriad ways in the local market at tremendous ratepayer and taxpayer expense.

All of this hurts not only competition, but consumers who otherwise reap the benefits of the competitive process. Local ratepayers are forced to subsidize the competitive ventures of the BOCs. Even if Ameritech's rates do not increase, the competition that would have driven costs down (and, in the end, prices) is absent. Second, consumers of competitive interLATA services are saddled with less efficient products and services because the market share of more efficient firms has been displaced by Ameritech -- not by better service but by misconduct.

For these reasons, the public interest requires that Ameritech not be authorized to provide in-region interLATA services at this time. The promise to help bring about local competition cannot be mistaken for competition itself. The Commission must hold Ameritech to its word, and then "verify" that it has in fact kept its word and further, "verify" that the intended results of competitive effects are observable, before interLATA relief can be granted.

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32 The FCC's Chief Economist has stated that "[t]hese problems are hard to regulate away, because the withdrawal of cooperation from rivals may be subtle, shifting, and temporary, but yet have real and permanent effects. . . " Farrell, Joseph, "Creating Local Competition," (speech as prepared for delivery) May 15, 1996, Washington, D.C. at 5.

Question No. 11. Should the public interest, as that phrase is used in Section 251(d)(3)(C), require the presence of viable local competition in at least all major markets within the State?

It is plain that Congress did not intend to allow BOC interLATA entry upon the mere showing of highly localized, insignificant entry. While Congress chose not to await statewide competition before allowing BOC authorization, it is appropriate to consider other markets throughout the State.

In assessing the adequacy of interconnection arrangements, the Commission needs to consider not only the presence of competitors in Grand Rapids and Detroit, but other significant areas of commerce and population. The competitive arrangements in Grand Rapids and Detroit relied upon by Ameritech must necessarily be available and workable in other parts of the State. As the House Report explained the section in the House bill that evolved into Section 271(c)(1)(A):[33]

> whatever agreement the competitor is operating under must be made generally available throughout the State. Any carrier in another part of the State could immediately take advantage of the "agreement" and be operational fairly quickly. . . .[34]

The House thus deemed this would:

> creat[e the] potential for competitive alternatives to flourish rapidly throughout a State, with an absolute minimum of lengthy and contentious negotiations once an initial agreement is entered into. . . .[35]

The issue, then, is not whether other local markets in the State are relevant, but rather what weight one must give to them.

Sprint submits that not only should the Commission consider the competitive evolution of other markets within Michigan, but it should also examine and weigh the prospects for competitive entry in other states in which Ameritech now enjoys enduring market power. This is especially relevant since a significant fraction of calls both originate and terminate in Ameritech's region. This

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[33] The Conference Report's ultimate adoption of Section 271 relied nearly exclusively upon the House evolution of that section. All versions of the House bill, from introduction, through Committee, to the substitute amendment approved on the House floor, contained the relevant requirement for the BOC to show an interconnection agreement with a competitive provider of local exchange service, and thus the House legislative history in this regard is authoritative.

[34] House Report at 77.

[35] Id.

circumstance, in effect, gives Ameritech two bites at the apple to slow the advent of competition, whether through manipulation of access charges, discrimination, or cross-subsidization.

Respectfully submitted,

SPRINT COMMUNICATIONS COMPANY, L.P.

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ITS ATTORNEYS

Dated: January 8, 1997

STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter, on the Commission's own motion, to consider Ameritech Michigan's compliance with the competitive checklist in Section 271 of the Telecommunications Act of 1996.	))))	**Case No. U-11104**

AFFIDAVIT OF EDWARD K. PHELAN
ON BEHALF OF SPRINT COMMUNICATIONS COMPANY L.P.

STATE OF MISSOURI)
) SS.
COUNTY OF JACKSON)

I, Edward K. Phelan, being first duly sworn upon oath, do hereby depose and state as follows:

1. My name is Edward K. Phelan. I am employed by Sprint Communications Company L.P. ("Sprint") as Staff Director, Regulatory Policy and Coordination. My address is 8140 Ward Parkway, Kansas City, Missouri 64114.

2. I have a Master of Arts degree in economics from Indiana State University. I hold a Bachelor of Science degree in economics from Lewis University. I have been employed by Sprint since November 1992. Before joining Sprint, I was Chief Economist for the Indiana Utility Regulatory Commission, beginning in June of 1989. Prior to that, I held the position of Assistant Chief Economist and Principle Utility Analyst. I was employed by the Indiana Department of Commerce in economic planning and research positions from 1974 through 1982.

3. My present responsibilities include coordinating with representatives of Sprint business units regarding regulatory matters, contributing to the development of Sprint regulatory policy, and testifying on behalf of Sprint concerning economic and regulatory policy matters in

telecommunications. I have participated in regulatory proceedings before the following state commission: Arizona, California, Hawaii, Illinois, Indiana, Michigan, Montana, New Mexico, Ohio, Oregon, Utah, and Wisconsin.

Subject of Statement

4. My testimony provides an economic framework for considering Ameritech's compliance with the competitive checklist in Section 271 of the Telecommunications Act of 1996.

Summary of Conclusions

5. My primary conclusion is that interconnection agreements must be demonstrated to be working in practice on a commercial scale before checklist compliance can be regarded as economically meaningful, and in order to meet the public-interest standard for approving Section 271 applications. Ameritech Michigan's ("Ameritech") submission shows that it has not yet begun providing interconnection to a competitor or set of competitors that represent significant facilities-based alternatives.

6. There is widespread agreement that the public interest will be served if states and the Federal Communications Commission ("FCC") take advantage of the historic opportunity provided by the 1996 Telecommunications Act to ensure that local telephone markets are opened up to competition. Since these markets are currently monopolized, economics tells us introducing competition into them offers potentially large social gains. To open these markets will require ongoing, extensive, and detailed cooperation from incumbent local exchange carriers (ILECs). No monopolist lightly relinquishes its dominant position. Recognizing this, Congress provided a powerful incentive for Bell Operating Company (BOC) cooperation by providing conditions necessary for BOCs to enter interLATA markets.

7. It would be a mistake to relinquish the 271 lever until local markets are demonstrably open. If 271 authorization is granted before we are confident that the required BOC cooperation has indeed been forthcoming and will continue, the strong incentives for BOC cooperation created by the

271 process will be lost, and the emergence of local competition will be undermined. This situation would be difficult to rectify, since 271 approval would be virtually impossible to reverse. On the other hand, if 271 approval is deferred until interconnection has been proven to work, such approval can then be granted quickly once local competition is enabled. Thus, uncertainty favors erring on the side of caution and withholding approval until interconnection has been clearly demonstrated.

8. Premature approval of 271 applications is especially dangerous since new entrant carriers (NECs) are so reliant on BOCs to gain even a foothold in local markets, and since the required cooperation is so multifaceted and complex. Because of these complexities, regulatory oversight will necessarily be highly imperfect, especially until procedures have been ironed out and interconnection has been proven to work in practice. To approve Ameritech's 271 application before the highly intricate and complex interconnection relationships between Ameritech and NECs have been demonstrated to work runs the risk of prematurely eliminating the major incentive for Ameritech to cooperate with its would-be rivals.

9. Checklist compliance, if it truly is to mean that local competition has been enabled, must require more than an agreement that exists only on paper. Economically meaningful checklist compliance requires that interconnection be shown to be working in practice. Very likely, the first interconnection agreements to be operationalized on a significant scale in Michigan will involve the resale of Ameritech's retail services. Sprint is planning to begin as a NEC in Michigan through resale. Thus, the first significant indication that interconnection is working in practice in Michigan will occur when resellers are able to achieve operational parity with Ameritech.

10. Of course, resale competition is not as powerful a force for consumer choice as is facilities-based competition, and Congress put some specific requirements in the Act stressing the key role of facilities-based competitors in local exchange markets. When resale is proven to work in practice, and if NECs have confidence that the regulatory environment will be conducive to competition, they will be willing to make the substantial sunk investments necessary to provide real,

facilities-based local competition. Even after such investments are made, however, it will remain important for the Commission to continue to press Ameritech to cooperate with NECs who are investing in fiber optic networks, switches, etc., to insure that these investments are not stranded or degraded, but rather form the basis for genuine new choices for consumers.

11. I base my conclusions on an economic analysis of the conditions of entry into local exchange markets. Since not even Ameritech argues that there is widespread local exchange competition throughout Michigan, my analysis focuses on the prospects for competition in local exchange markets in Michigan, and the barriers to entry into those markets. Until the barriers are definitely down, however, and actual competitors are observable in the market, there remains a very real risk that 271 authorization will adversely affect the emergence of local competition, by removing much of the pressure on Ameritech to cooperate with NECs. This would be contrary to the public interest.

Economic Objectives in 271 Applications: General Principles

12. There are four major economic and policy objectives that must be balanced in evaluating BOC Section 271 applications to offer in-region long-distance service. Ultimately, determining whether in-region interLATA authorization for Ameritech would be consistent with the public interest, convenience, and necessity turns on the impact of authorization in these four areas. These factors are: (1) expansion of consumer choice in local markets; (2) providing additional competition in interLATA markets; (3) preventing anticompetitive conduct in the provision of exchange access; and (4) leveling the playing field as markets merge.

13. The 1996 Telecommunications Act provides an historical chance to open up local exchange markets, which are the most significant remaining bottleneck monopolies in the telecommunications sector. If our experience in long-distance markets is any guide, the introduction of competition into local exchange markets will generate substantial consumer benefits in the form of new services and lower prices.

14. Introducing competition into local exchange service will require the cooperation of the incumbent local exchange carriers (ILECs). This cooperation is unlikely to be voluntary: no monopolist, regulated or not, is keen to relinquish its dominant position.

15. Of course, the Commission, like other State Commissions, has some authority to compel Ameritech to cooperate with would-be competitive local exchange carriers, at least along some well-defined and observable dimensions. But direct regulation of Ameritech's conduct in and of itself will not be enough. There is too much scope for Ameritech to get around the spirit if not the letter of the interconnection rules, and to impose its own interpretation of its interconnection duties, at least until many aspects of interconnection are tested in practice and understood by competitive local exchange carriers as well as the Commission.

16. So long as 271 authorization remains pending, Ameritech has incentives to fix problems with NECs in a hurry; once 271 authorization is granted, Ameritech will have fewer incentives quickly to resolve disputes over the myriad details of interconnection, although NECs will remain heavily dependent upon Ameritech. This highly asymmetric situation is simply not as conducive to resolving the many interconnection issues vital to making local exchange competition a reality.

17. The implication of this analysis is that the path to genuine local competition will be far smoother if Ameritech, and the other BOCs, are given incentives to cooperate to make local competition truly possible, to partially offset their natural economic incentives to protect their monopoly positions. By insisting, as a condition for entry into in-region interexchange service, that Ameritech demonstrate that it has put in place the conditions necessary for local competition to flourish, in practice and not just on paper, the 271 process can be used to induce cooperation. This *quid pro quo* is central to the development of local exchange competition.

18. Long-distance entry by Ameritech is not just a reward for providing meaningful interconnection with local rivals; it has direct implications for long-distance markets.

19. If Ameritech can be prevented from misusing its bottleneck local monopoly to disadvantage its long-distance rivals, then permitting Ameritech to enter the long-distance market will make that market more competitive. One reason to insist that local competition has truly been enabled before granting 271 authorization is to reduce the dangers of such misuse.

20. In any overall balancing of impacts on local and long-distance markets, it is important to remember that the long-distance market in the U.S. is currently far more competitive than are local exchange markets served by Ameritech. Therefore, the incremental benefits of entry into long distance are likely to be smaller than the corresponding benefits from entry into local exchange.

21. Three considerations limit any benefits to consumers in long-distance markets from Ameritech's entry into those markets. First, there is the danger that Ameritech will use its bottleneck local monopoly to reduce competition in long distance. Second, the benefits from adding another competitor to the long-distance market are muted in comparison with adding a competitor to monopolized market. Third, to the extent that Ameritech is a reseller of long-distance services rather than a facilities-based competitor, its impact on long-distance markets is less pronounced.

22. Just as in the old Bell System, an integrated provider may have economic incentives to use its local exchange bottleneck to disadvantage long distance rivals. Because of this danger, one cannot conclude that entry by a BOC into in-region long-distance markets will necessarily enhance competition in long-distance markets.

23. If regulation is ineffective in preventing discrimination against rival interexchange carriers, BOC entry into long distance actually harms consumers in interexchange markets. Discrimination is especially harmful to consumer welfare and the public interest because it lowers the quality of service that interexchange rivals can provide to their customers, with little or no offsetting cost savings. Economists widely agree that such quality degradation is even more harmful to the public interest than conventional monopoly overcharges with their associated deadweight losses.